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PART I

THE VIET CONG ECONOMY

A. Economic Organization

The Viet Cong have successfully developed and expanded an economic organization to meet the basic task of funding VC revolutionary activity. The economic organization, operating through the Finance and Economic Section of the People's Revolutionary (Communist) Party, is assisted by the National Liberation Front and Communist military components in acquiring, transporting, and storing within South Vietnam almost all the non-military supplies required by the VC. During the past five years, the VC economic organization has expanded with the development of VC forces. Starting as a local self-production unit, the economic structure progressed, first into a voluntary fund drive, then, into a more formally organized financial mechanism and, finally into an organization actively supporting enlarged base and battlefield requirements.

Taxation is the principal means used by the VC to acquire financial and material resources within South Vietnam. Agricultural taxation remains the most important source of VC tax receipts, accounting for approximately 80 percent of all tax revenues, and is clearly dependent on continuing VC access to or some measure of control over the rural population. The VC currently exercise predominant political influence over 25 to 30

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percent of the rice-cultivated area of South Vietnam, which produces between 700,000 and 950,000 metric tons of rice per year. Annual consumption of rice by Communist regular forces theoretically could be obtained by an average tax of about 3 percent of total production in VC areas alone. The VC, however, usually tax at a substantially higher level (10 to 15 percent). This is necessary to build up rice reserves for the increasing number of communist troops, to replenish stocks destroyed by Allied Military Operations, to help feed the large number of non-main force troops, as well as to cover the purchases of other food and non-food items. There is no indication that resentment by the rural population against taxes of this magnitude has reached levels adequate to stop rice collections. Plantation taxes -- either in money, goods or services -- continue to be collected and are an important source of supply for VC forces, particularly in the northern III Corps. In addition to taxes on agriculture, taxes are collected on internal transportation, business establishments, and commercial activities. These provide about 20 percent of all tax revenues.

VC-initiated economic activities, seizures, and clandestine operations supplement VC tax receipts. Bond drives, food production, and simple manufacturing units have been initiated by the VC to support military personnel. Significant supplies of war booty continue to be accumulated by the VC. Clandestine front business operations and discreet purchases by civilians

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acting for the VC, provide access to resources from GVN-controlled areas, including imported manufactured goods.

VC use of Cambodia as a source of non-military supplies has increased significantly since late 1965, although the main source of VC supplies still comes from within South Vietnam. One important commodity reaching the VC from Cambodia is rice. Estimates of VC requirements for rice in the deficit areas of the Highlands of South Vietnam and for the Communist infiltration network of southern Laos indicate that 20,000 metric tons and possibly as much as 30,000 metric tons of Cambodian rice may have reached VC/NVA forces from late 1965 through 1966. Although local Cambodian civilian and military officials probably are aware and possibly involved in shipping rice to the VC, the extent of central government involvement is difficult to determine. In addition to rice, the VC are acquiring in Cambodia significant quantities of explosive chemicals, communications equipment, pharmaceuticals, gasoline, cloth, salt, fish and fish sauce.

B. The Economic Impact of Increased Military Pressure

The build-up in VC/NVA forces in South Vietnam during the last year has placed a heavy strain on VC logistical operations. Confirmed VC/NVA main force strength has more than doubled since mid-1965 -- from 48,000 then to a current strength of 105,000. Whereas guerrilla personnel, like the civilian population, are expected to be self-sufficient in basic supplies,

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main force units require extensive logistical support. Food supplies, especially rice, remain the principal bulk commodities required by these forces. For example, regimental main force units are directed to maintain at least a one-month reserve of rice. The entire increase in main force strength has been recorded in rice-deficit areas, namely I and II Corps and northern III Corps. There has been little, if any, increase in VC main force strength in the rice-surplus IV Corps where VC logistical requirements for food supplies are relatively small.

With the concentration of VC/NVA main force strength in I and II Corps and in northern III Corps, annual rice requirements clearly exceed the total rice production under VC control in the provinces of Pleiku, Kontum, Phu Bon, the western districts of the coastal provinces of Central Vietnam, and the rice-deficit areas of VC military region VII. In all of these areas, there is evidence that the VC are experiencing food supply problems. For example, a recently captured document cited the logistical difficulties experienced by the VC during an early 1966 campaign in rice-deficit Quang Duc Province. Since the VC did not have sufficient rice for its own provincial force VC regional forces assigned to the campaign were required to arrange their own rice supply "through the border," presumably the Cambodian border. During the course of the campaign, one-third of VC combat strength was diverted to the transportation of rice.

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The increase in allied military action has continued to hamper the VC logistical system. Allied military actions have had an adverse effect on agricultural production in VC controlled areas and on the percentage of the harvest that the VC can acquire and transport to their base areas. The area covered and percentage of crop harvested in these rice-harvesting operations is not reported, and no reliable aggregative estimate of their impact is possible. Even with continued VC access to rice-producing areas, however, the VC face a second major difficulty in transporting this commodity. The bulk of this movement has been carried out by civilian laborers, but as the tempo of military activity has increased the danger of involvement in military action has caused serious disaffection among the VC controlled population. A third major difficulty caused by allied military activity has been the disruption caused by allied destruction of VC supply caches.

C. Manpower Recruitment

The South Vietnamese population in VC controlled areas is at least 3.5 million people and could be as much as 5 million people depending on the extent to which the VC have access to contested areas. Most of the VC controlled population live in the delta region. This controlled population probably contains some 500,000 physically fit young males. An additional 30,000 to 35,000 youths annually become old enough to fight. In

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addition to this controlled population, the VC also draw on the population of military age in contested areas, on GVN deserters and on recruits from urban areas.

An increasing requirement for manpower during 1965 and 1966 forced the VC to resort to forced conscription, returnee programs, and various inducements to obtain local personnel. With these new methods the VC were able to attain a significantly higher level of local recruitment -- over 80,000 in 1965 compared to 30,000 to 40,000 annually during 1961-64. It is estimated that the VC have a capability in 1966 to recruit and train some 7,000 to 10,000 personnel a month.

Recruitment at this scale must be regarded as close to the maximum capabilities of the VC, particularly if these recruits are to receive adequate training. There have been increasing signs of a growing squeeze on VC manpower during 1966. This is reflected in the growing dominance of North Vietnamese troops as the VC/NVA force expands. There are also frequent prisoner reports of manpower shortages and the poor quality and training of new recruits.

PART II

THE GVN ECONOMY

A. Background

Among South Vietnam's many economic problems, inflation is most likely to influence the political situation in South Vietnam. For more than a year, South Vietnam has been gripped by a severe inflation primarily caused by heavy US and GVN spending for war operations. Greatly increased demand has not been matched by increased output, nor have imports bridged the gap. By June 1966, the inflationary process had reached such critical proportions -- the cost of living was 75 percent above the January 1965 level -- that the GVN was forced to devalue its currency by 50 percent in order to absorb excess purchasing power and drive down black market rates for dollars and gold.

The immediate results of these measures were encouraging. Prices rose, as expected, about 25 percent during July and then held fairly steady at this new higher level during August and September. In October, prices actually declined slightly. Moreover, black market rates for dollars and gold moved down well below the rates prevailing in June and July and continued to hold steady at these lower levels.

It appeared, therefore, that a modicum of economic stability had been achieved. Beginning in late October, however, the cost of living began to edge up again, and during November prices were,

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on the average, about 7 percent above the October level. Even more ominous was the fact that the price of rice -- a commodity that accounts for 13 percent of the Vietnamese working class family budget -- began to increase steadily and by mid-November reached a new 1966 high, which was 25 percent above the average September price and 32 percent above the level prevailing just prior to the June devaluation.

B. Prospects

Although the rise in the cost of living in November apparently stemmed from supply and demand developments in specific commodities -- most notably rice and pork -- there are a number of more basic threats that could send the inflation soaring again. Among these are increased US and GVN spending, the Saigon regime's inability to increase agricultural production, and port congestion. In view of this situation, the US is now vigorously attempting to secure GVN agreement to a 1967 economic stabilization program that would impose strict plaster ceilings on both US and GVN spending. The ceilings proposed by the US would probably result in at least a 20 percent increase in the cost of living in 1967 -- a tolerable increase. Whether the line can be held at these levels, however, is subject to considerable doubt.

In order to improve agricultural production, the US is attempting to gain GVN approval of a new rice price policy that would include raising the price of rice in order to provide an

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incentive to the farmer to increase production. The new policy should be implemented before the harvest of the new crop begins this month in order that benefits of higher prices will accrue to the farmer and favorably influence next year's rice production. Otherwise, higher rice prices would result only in urban dissatisfaction without improvement in the rural attitude toward the government or the desired increase in production. Although some GVN officials appear to have finally developed a sense of urgency on this issue, no final agreement has yet been reached.

Another element essential for the maintenance of relative economic stability in 1967 is the continuation of an adequate flow of imports into South Vietnam. Sufficient inflows of commodities will depend primarily on a significant improvement in Saigon port operations. Although the port situation has improved somewhat over the past several months, the ability to pass the necessary tonnages through the port still is far from assured. A further complicating factor will be the ability of the GVN to move commodities within the country to points where they are needed, an operation that has been greatly impeded not only by insecurity but also by GVN administrative weaknesses.

In brief, continued inflation is to be expected. If, however, the GVN can be persuaded to take forceful action in the areas outlined above, the increase in prices probably can be held within tolerable limits.

C. Political Implications

Inflation has significant implications for political stability within the GVN. A large segment of the Vietnamese work force has been caught in the squeeze between fairly stable incomes and rapidly rising prices. This is particularly true of Vietnamese civil servants and military personnel. The result has been a lowering of morale and a rise in corruption among underpaid government employees. Moreover, although the effects of the inflation probably fall most heavily on the urban lower and middle classes -- the most likely potential sources of political unrest -- the rural areas also have suffered. Higher prices in the provinces result not only from the inflation but also from disruptions in the supply and distribution system.

In general, inflation has increased dissatisfaction with the GVN and in addition, has provided a basis in everyday experience for Viet Cong anti-GVN and anti-US propaganda. Illustrative of the continuing Viet Cong effort to focus attention on GVN economic problems is a recent lengthy Viet Cong radio commentary that pictured the GVN economy near bankruptcy, small business on the verge of collapse, and prices constantly rising. Moreover, the Viet Cong in IV Corps are currently expounding the theme that the expected arrival of US troops in the Mekong Delta will drive prices up further in that area. It appears likely that if the proposed economic stabilization plan for 1967 does not succeed and prices resume their previous rapid rise, the GVN will be faced with widespread popular discontent.